

AUDITING PROCEDURES REPORT

Issued under P.A. 2 of 1968, as amended. Filing is mandatory.

Local Government Type <input type="checkbox"/> City <input type="checkbox"/> Township <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Government Name Pathways		County Marquette
Audit Date 9/30/05	Opinion Date 4/28/06	Date Accountant Report Submitted to State: 9-18-06		

We have audited the financial statements of this local unit of government and rendered an opinion on financial statements prepared in accordance with the Statements of the Governmental Accounting Standards Board (GASB) and the *Uniform Reporting Format for Financial Statements for Counties and Local Units of Government in Michigan* by the Michigan Department of Treasury.

We affirm that:

1. We have complied with the *Bulletin for the Audits of Local Units of Government in Michigan* as revised.
2. We are certified public accountants registered to practice in Michigan.

We further affirm the following. "Yes" responses have been disclosed in the financial statements, including the notes, or in the report of comments and recommendations

You must check the applicable box for each item below.

- ☐ yes ☒ no 1. Certain component units/funds/agencies of the local unit are excluded from the financial statements.
- ☒ yes ☐ no 2. There are accumulated deficits in one or more of this unit's unreserved fund balances/retained earnings (P.A. 275 of 1980).
- ☒ yes ☐ no 3. There are instances of non-compliance with the Uniform Accounting and Budgeting Act (P.A. 2 of 1968, as amended).
- ☐ yes ☒ no 4. The local unit has violated the conditions of either an order issued under the Municipal Finance Act or its requirements, or an order issued under the Emergency Municipal Loan Act.
- ☐ yes ☒ no 5. The local unit holds deposits/investments which do not comply with statutory requirements. (P.A. 20 of 1943, as amended [MCL 129.91], or P.A. 55 of 1982, as amended [MCL 38.1132]).
- ☐ yes ☒ no 6. The local unit has been delinquent in distributing tax revenues that were collected for another taxing unit.
- ☐ yes ☒ no 7. The local unit has violated the Constitutional requirement (Article 9, Section 24) to fund current year earned pension benefits (normal costs) in the current year. If the plan is more than 100% funded and the overfunding credits are more than the normal cost requirement, no contributions are due (paid during the year).
- ☐ yes ☒ no 8. The local unit uses credit cards and has not adopted an applicable policy as required by P.A. 266 of 1995 (MCL 129.241).
- ☐ yes ☒ no 9. The local unit has not adopted an investment policy as required by P.A. 196 of 1997 (MCL 129.95).

We have enclosed the following:

	Enclosed	To Be Forwarded	Not Required
The letter of comments and recommendations.	✓		
Reports on individual federal financial assistance programs (program audits).			✓
Single Audit Reports (ASLGR).	✓		

Certified Public Accountant (Firm Name) Anderson, Tackman & Co. PLLC			
Street Address 102 W. Washington, Suite 109	City Marquette	State MI	ZIP 49855
Accountant Signature Dulceca Hills CPA			

**Pathways
Financial Statements
September 30, 2005**

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ANDERSON, TACKMAN & COMPANY, P.L.C.

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INDEPENDENT AUDITOR'S REPORT

Members of the Board
Pathways
Marquette, Michigan 49855

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2005, which collectively comprise the Pathways' basic financial statements as listed in the foregoing table of contents. These financial statements are the responsibility of the Pathways' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways as of September 30, 2005, and the respective changes in financial position and the cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 28, 2006, on our consideration of Pathways internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis and budgetary comparison information on pages 5 through 9 and 33 through 34, respectively, are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Members of the Board
Pathways
Marquette, Michigan 49855

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Pathways basic financial statements. The other supplementary information listed in the table of contents is presented for the purpose of additional analysis and is not a required part of the basic financial statements of Pathways. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Anderson, Tackman & Company, PLLC
Certified Public Accountants

April 28, 2006

Pathways

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED)

Our discussion and analysis of Pathways financial performance provides an overview of Pathways financial activities for the year ended September 30, 2005. Please read it in conjunction with the financial statements, which begin on page 10.

FINANCIAL HIGHLIGHTS

- Net assets for Pathways as a whole were reported at \$329,650. Net assets are comprised of 100% governmental activities.
- During the year, Pathways expenses were \$74,938,278, while revenues from all sources totaled \$73,223,380, resulting in a decrease in net assets of \$1,714,898.
- The general fund reported a decrease in fund balance of \$1,833,240. Revenues were \$426,583 below the budgeted amount of \$73,776,700 and expenditures and transfers out were \$1,292,118 above the budgeted amount of \$73,891,239.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 10 and 11) provide information about the activities of Pathways as a whole and present a longer-term view of Pathways finances. Fund financial statements start on page 12. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for the future spending. Fund financial statements also report Pathways operations in more detail than the government-wide statements by providing information about Pathways most significant funds.

Reporting Pathways as a Whole

Our analysis of Pathways as a whole begins on page 6. One of the most important questions asked about Pathways' finances is "Is Pathways as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about Pathways as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid. These two statements report Pathways' *net assets* and changes in them. You can think of Pathways net assets - the difference between assets and liabilities - as one way to measure Pathways' financial health, or *financial position*. Over time, *increases or decreases* in Pathways' net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other non-financial factors, however, such as changes in Pathways' client base and the condition of Pathways' capital assets, to assess the *overall financial health* of Pathways.

In the Statement of Net Assets and the Statement of Activities, we divide Pathways into two kinds of activities:

- Government activities – All of Pathways basic services are reported here including client services and general administration. Medicaid and Department of Community Health revenues and other state and federal grants fund most of these activities.

Pathways

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

- Business-type activities- Pathways currently does not engage in any business-type activities defined as activities financed by fees charged to external parties who use certain goods or services.

Reporting Pathways' Most Significant Funds

Our analysis of Pathways' major funds begins on page 8. The fund financial statements begin on page 12 and provide detailed information on the most significant funds – not Pathways as a whole. Some funds are required to be established by State law, and by bond covenants. However, the Pathways Board has established other funds to help it control and manage money for particular purposes. Pathways' two kinds of funds - *governmental* and *proprietary* – use different accounting methods.

- *Governmental funds* – Most of Pathways' services are reported in governmental funds which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other financial assets that can be readily converted into cash. The governmental fund statements provide a detailed *short-term* view of Pathways' general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance Pathways' programs. We describe the relationship (or differences) between *governmental activities* (reported in the Statement of Net Assets and Statement of Activities) and *governmental funds* in a reconciliation which follows the fund financial statements.
- *Proprietary funds* – When Pathways charges customers for the services it provides – whether to outside customers or to other units of Pathways – these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. We use internal service funds (the only component of Pathways proprietary funds) to report activities that provide supplies and services for Pathways other programs and activities – such as Pathways' Employee Benefit Fund, Medicaid Risk Reserve Fund and Equipment Fund.

Pathways as a Whole

Table 1 provides a summary of Pathways' net assets at September 30, 2005 and 2004:

**Table 1
Net Assets**

	Governmental Activities - 2005	Governmental Activities - 2004
Current assets	\$3,904,520	\$ 6,708,666
Capital assets, net	<u>5,953,549</u>	<u>3,565,623</u>
Total Assets	<u>9,858,069</u>	<u>10,274,289</u>
Current liabilities	4,956,520	5,213,823
Noncurrent liabilities	<u>4,571,899</u>	<u>3,000,308</u>
Total Liabilities	<u>9,528,419</u>	<u>8,214,131</u>
Net Assets:		
Invested in capital assets, net of related debt	2,304,548	2,130,570
Restricted	773,146	770,096
Unrestricted (deficit)	<u>(2,748,044)</u>	<u>(840,508)</u>
Total Net Assets	<u>\$ 329,650</u>	<u>\$ 2,060,158</u>

Pathways

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

Net assets of Pathways' governmental activities stood at \$329,650. Unrestricted net assets—the part of net assets that could be used to finance day-to-day activities without constraints established by debt covenants, enabling legislation, or other legal requirements stood at a \$2,748,044 deficit.

The results of this year's operations for the Board as a whole are reported in the Statement of Activities (see Table 2), which shows the changes in net assets for fiscal years 2005 and 2004.

Table 2
Changes in Net Assets

	Governmental Activities - 2005	Governmental Activities - 2004
Revenues:		
Program revenues:		
Charges for services	\$537,740	\$ 1,014,561
Operating grants and contributions	69,233,697	65,739,886
General revenues:		
State sources not restricted to specific program	3,089,392	3,654,036
Investment earnings	14,125	14,363
Gain (loss) on sale of capital assets	92,952	(34,248)
Miscellaneous	255,474	441,511
Total Revenues	<u>73,223,380</u>	<u>70,830,109</u>
Expenses:		
General government	74,908,867	72,780,407
Interest on long-term debt	29,411	25,036
Total Expenses	<u>74,938,278</u>	<u>72,805,443</u>
Change in net assets	(1,714,898)	(1,975,334)
Net assets, beginning	2,060,158	3,824,154
Prior period adjustments	<u>(15,610)</u>	<u>211,338</u>
Net Assets, Ending	<u>\$329,650</u>	<u>\$2,060,158</u>

Pathways' total revenues were \$73,223,380. The total cost of all programs and services was \$74,938,278, resulting in a decrease in net assets of \$1,714,898. The deficit is attributable to an unforeseen decrease in revenue which consisted of one time adjustments to Account Receivable. These adjustments were to write off old balances and also adjust the percentage of estimated collections on remaining balances. Pathways Accounts Receivable system was enhanced over the last two years. Outstanding balances in excess of 12-18 months old were written off. Our ability to collect personal payment revenue is directly related to Pathways' focus on priority populations. Generally speaking, our priority populations consist of the most severely disabled and have the least ability to pay for services. Another factor was a reduction in Habilitation Support Waiver slots due to a freeze by MDCH. It should be noted that all but three of these slots were restored in 2006. Purely from an operations perspective, Pathways did not deficit spend.

Table 3 presents the cost of Pathways' major activity – General Government – as well as the program's net cost (total cost less revenues generated by the activities). The net cost shows the financial burden that this function placed on the Pathways operation.

Pathways

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

Table 3
Governmental Activities

	2005		2004	
	Total Cost of Services	Net Cost of Services	Total Cost of Services	Net Cost of Services
General Government	<u>\$74,908,867</u>	<u>\$5,137,430</u>	<u>\$72,870,407</u>	<u>\$6,025,960</u>

PATHWAYS' FUNDS

As Pathways completed the year, its governmental funds (as presented in the balance sheet on page 12) reported a combined fund balance of \$(1,361,149), a decrease of \$1,837,248 from the beginning of the year including prior period adjustments of \$(15,610). As noted above, unexpected decreases in revenues and the inability to adjust the operational budget for these decreases contributed to the decrease in fund balance.

General Fund Budgetary Highlights

Over the course of the year, the Pathways Board revised the budget a few times. The purpose of these revisions is to recognize major changes in revenue or expenses. Expense and revenue budgets are corrected throughout the year based on actual year to date expenses and revenue as well as updated projections.

With these adjustments, actual charges to expenditures and transfers out were \$1,292,118 higher than the final amended budget. Conversely, revenues were \$426,583 lower than the final budget projection resulting in a \$1,833,240 decrease in fund balance compared to a planned decrease in fund balance of \$114,539. Higher than expected inpatient utilization and residential contract costs were the major contributors to this variance.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal 2005, Pathways had \$5,953,549 invested in a variety of capital assets including buildings, vehicles and other equipment. (See table 4 below)

Table 4
Capital Assets at Year-End

	Governmental Activities - 2005	Governmental Activities - 2004
Land	\$547,694	\$ 363,000
Land improvements	-	-
Buildings	5,038,274	3,166,761
Building improvements	95,055	89,670
Equipment and furnishings	2,810,417	2,348,512
Vehicles	1,492,778	1,441,356
Accumulated depreciation	<u>(4,030,669)</u>	<u>(3,843,676)</u>
Totals	<u>\$ 5,953,549</u>	<u>\$ 3,565,623</u>

Pathways

MANAGEMENT DISCUSSION AND ANALYSIS (UNAUDITED) (Continued)

Debt

At year-end, Pathways had \$3,893,111 in notes outstanding as depicted in Table 5 below.

Table 5		
Outstanding Debt at Year-End		
	<u>Governmental Activities - 2005</u>	<u>Governmental Activities - 2004</u>
Installment contracts payable	\$244,110	\$ 692,301
Equipment notes payable	3,393,974	1,358,660
Line of credit	255,027	76,393
Totals	<u>\$3,893,111</u>	<u>\$2,127,354</u>

New additions to debt for this year include \$679,154 for equipment purchases and \$2,050,000 for building purchases. See Note J for further details on long-term debt.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS

Pathways appointed officials consider many factors when setting the fiscal year 2006 budget. The General Fund allocation to Pathways was increased by \$225,000. The Habilitation Supports Waiver slots were restored to within three slots of 2004 levels. Four remaining Pathways' directly operated group homes were contracted out 8/1/06 to Lutheran Social Services and Bay Human Services. The impact of \$500,000 in calculated savings will be fully realized in 2007. Measures have been taken to scrutinize operational expenditures. Pathways continues to experience higher utilization for inpatient hospital days. Additional measures are being taken to consider discontinuation of nonessential programs and to adjust health insurance benefits in 2007 by increase co-pays and deductibles.

CONTACTING PATHWAYS FINANCIAL MANAGEMENT

This financial report is designed to provide our clients, customers, and investors and creditors with a general overview of Pathways' finances and to show Pathways' accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Pathways Executive Director at Pathways, 200 West Spring Street, Marquette, Michigan, 49855.

Pathways

Statement of Net Assets

September 30, 2005

	Governmental Activities
ASSETS	
Current Assets:	
Cash and cash equivalents	\$ -
Investments	1,566,166
Restricted assets	758,099
Receivables, net:	
Client fees	424,434
Other	522,473
Grants	80,196
Due from State of Michigan	80,164
Due from local units	-
Inventory	89,187
Prepaid expenses	369,399
Other assets	14,402
Total Current Assets	<u>3,904,520</u>
Noncurrent Assets:	
Capital assets:	
Land	547,694
Other capital assets	9,436,524
Accumulated depreciation	(4,030,669)
Total Noncurrent Assets	<u>5,953,549</u>
TOTAL ASSETS	<u>9,858,069</u>
LIABILITIES	
Current Liabilities:	
Cash overdraft	265,526
Accounts payable	1,992,392
Due to State of Michigan	164,591
Due to counties - liquor tax	491,961
Accrued payroll and related	1,083,381
Accrued retirement contribution	10,056
Other current liabilities	-
Deferred revenue	170,785
Notes payable	777,828
Total Current Liabilities	<u>4,956,520</u>
Noncurrent Liabilities:	
Compensated absences	1,456,616
Notes payable	3,115,283
Total Noncurrent Liabilities	<u>4,571,899</u>
TOTAL LIABILITIES	<u>9,528,419</u>
NET ASSETS	
Invested in capital assets, net of related debt	2,304,548
Restricted for:	
Medicaid savings carryforward	-
Medicaid risk reserve	763,086
Debt service	10,060
Unrestricted	(2,748,044)
TOTAL NET ASSETS	<u>\$ 329,650</u>

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Statement of Activities

For the Fiscal Year Ended September 30, 2005

Function/Program	Expenses	Program Revenue			Net (Expense) Revenue and Changes in Net Assets
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Governmental Activities:					
General government	\$ 74,908,867	\$ 537,740	\$ 69,233,697	\$ -	\$ (5,137,430)
Interest on long-term debt	29,411	-	-	-	(29,411)
Total Governmental Activities	\$ 74,938,278	\$ 537,740	\$ 69,233,697	\$ -	(5,166,841)
General revenues:					
State sources not restricted to specific program					3,089,392
Investment earnings					14,125
Gain (loss) on disposal of assets					92,952
Miscellaneous					255,474
				Total general revenues	3,451,943
				Changes in net assets	(1,714,898)
Net assets, beginning of year					2,060,158
Prior period adjustment for Medicaid risk carryforward					-
Prior period adjustment for contributions					14,408
Prior period adjustment for Medicaid settlements					(30,018)
Net assets, beginning of year, as restated					2,044,548
				NET ASSETS, END OF YEAR	\$ 329,650

The accompanying notes to financial statements are an integral part of this statement.

Pathways
Governmental Funds
Balance Sheet

September 30, 2005

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
ASSETS			
Cash and cash equivalents	\$ -	\$ 4,921	\$ 4,921
Investments	429,400	84,495	513,895
Accounts receivable:			
Client fees	424,434	-	424,434
Other	512,413	10,060	522,473
Grants receivable	80,196	-	80,196
Due from State of Michigan	80,164	-	80,164
Due from other funds	524,261	-	524,261
Inventory	89,187	-	89,187
Restricted assets	758,099	-	758,099
Prepaid expenditures	369,399	-	369,399
Other assets	-	14,402	14,402
TOTAL ASSETS	\$ 3,267,553	\$ 113,878	\$ 3,381,431
LIABILITIES AND FUND BALANCE			
LIABILITIES:			
Cash overdraft	\$ 1,016,596	\$ -	\$ 1,016,596
Accounts payable	1,992,392	-	1,992,392
Due to State of Michigan	164,591	-	164,591
Due to counties - liquor tax	491,961	-	491,961
Due to other funds	-	-	-
Accrued payroll and related	896,199	-	896,199
Accrued retirement contribution	10,056	-	10,056
Other current liabilities	-	-	-
Deferred revenue	170,785	-	170,785
TOTAL LIABILITIES	4,742,580	-	4,742,580
FUND BALANCE:			
Reserved for:			
Debt service	-	10,060	10,060
Unreserved, reported in:			
General Fund	(1,475,027)	-	(1,475,027)
Special Revenue Funds	-	103,818	103,818
TOTAL FUND BALANCE	(1,475,027)	113,878	(1,361,149)
TOTAL LIABILITIES AND FUND BALANCE	\$ 3,267,553	\$ 113,878	\$ 3,381,431

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets

September 30, 2005

Total Fund Balances for Governmental Funds	\$ (1,361,149)
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*Amounts reported for governmental activities in the statement
of net assets are different because:*

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds	5,953,549
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Internal service funds are used by Pathways to charge the cost of equipment usage and employee benefits to the General Fund. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets, net of capital assets.	(4,018,640)
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Long-term liabilities, including notes payable, are not due and payable in the current period and therefore are not reported in the funds	(244,110)
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Net Assets of Governmental Activities	\$ 329,650
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The accompanying notes to financial statements are an integral part of this statement.

Pathways

Governmental Funds Statement of Revenues, Expenditures and Changes in Fund Balance

For the Fiscal Year Ended September 30, 2005

	General Fund	Other Nonmajor Governmental Funds	Total Governmental Funds
REVENUES:			
State sources	\$ 69,900,865	-	\$ 69,900,865
Contracts and grants	2,612,105	-	2,612,105
Charges for services	2,408,268	-	2,408,268
Local sources	964,351	10,596	974,947
Investment income	12,869	1,256	14,125
Other	1,308,480	-	1,308,480
Less deductions from revenue:			-
Donated services discounts	(1,870,528)	-	(1,870,528)
Medicaid general funding carryforward	(677,900)	-	(677,900)
Local match - Medicaid draw down	(1,303,991)	-	(1,303,991)
Public Act 423 of 1980	(4,402)	-	(4,402)
TOTAL REVENUES	73,350,117	11,852	73,361,969
EXPENDITURES:			
Current operations	74,633,992	5,850	74,639,842
Debt service:			
Principal	-	448,191	448,191
Interest and fiscal charges	-	29,411	29,411
Capital outlay	66,263	-	66,263
TOTAL EXPENDITURES	74,700,255	483,452	75,183,707
EXCESS REVENUES OVER (UNDER) EXPENDITURES	(1,350,138)	(471,600)	(1,821,738)
OTHER FINANCING SOURCES (USES):			
Loan proceeds	-	-	-
Transfers in	-	483,102	483,102
Transfers (out)	(483,102)	-	(483,102)
TOTAL OTHER FINANCING SOURCES (USES)	(483,102)	483,102	-
NET CHANGE IN FUND BALANCE	(1,833,240)	11,502	(1,821,738)
Fund balance, beginning of year	388,231	87,968	476,199
Prior period adjustment for contributions	-	14,408	14,408
Prior period adjustment for Medicaid settlements	(30,018)	-	(30,018)
Fund balance, beginning of year, as restated	358,213	102,376	460,589
FUND BALANCE, END OF YEAR	\$ (1,475,027)	\$ 113,878	\$ (1,361,149)

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balance of Governmental Funds to the Statement of Activities

For the Fiscal Year Ended September 30, 2005

Net Change in Fund Balances - Total Governmental Funds	\$ (1,821,738)
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*Amounts reported for governmental activities in the statement
of activities are different because:*

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount of depreciation expense recorded in the current period.	(162,071)
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Internal service funds are used by Pathways to charge the cost of equipment usage and employee benefits to the General Fund. The net revenue (expense) of the internal service funds is reported with governmental activities, net of depreciation expense of \$439,476	(40,691)
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Gain on disposal of capital assets is not reported in the governmental funds, but is reported in the statement of activities.	92,952
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Proceeds on sale of capital assets are reported in the governmental funds, but included in the gain on disposal of capital assets amount in the statement of activities.	(231,541)
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Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	448,191
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Change in Net Assets of Governmental Activities	<u>\$ (1,714,898)</u>
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The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds Statement of Net Assets

September 30, 2005

	Internal Service Funds
ASSETS	
Current Assets:	
Cash and cash equivalents	\$ 746,149
Investments	1,052,271
Due from local units	-
Due from other funds	-
Total Current Assets	<u>1,798,420</u>
Capital Assets:	
Capital assets	5,169,796
Accumulated depreciation	(996,534)
Total Noncurrent Assets	<u>4,173,262</u>
TOTAL ASSETS	<u>5,971,682</u>
LIABILITIES	
Current Liabilities:	
Accounts payable	-
Due to other funds	524,261
Accrued payroll and related	187,182
Current maturities of long-term debt	672,574
Total Current Liabilities	<u>1,384,017</u>
Long-term Liabilities:	
Compensated absences	1,456,616
Notes payable	2,976,427
Total Long-term Liabilities	<u>4,433,043</u>
TOTAL LIABILITIES	<u>5,817,060</u>
NET ASSETS	
Invested in capital assets, net of related debt	-
Restricted	763,086
Unrestricted	(608,464)
TOTAL NET ASSETS	<u>\$ 154,622</u>

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds Statement of Revenues, Expenses and Changes in Net Assets

For the Fiscal Year Ended September 30, 2005

	Internal Service Funds
OPERATING REVENUES:	
Charges for services	\$ 2,923,320
Other	4,242
TOTAL OPERATING REVENUES	<u>2,927,562</u>
OPERATING EXPENSES:	
Personnel services	2,387,774
Other services and charges	160
Depreciation	439,476
TOTAL OPERATING EXPENSES	<u>2,827,410</u>
OPERATING INCOME (LOSS)	<u>100,152</u>
NON-OPERATING REVENUES (EXPENSES):	
Interest income	23,087
Interest expense	(163,930)
Transfers from local units	-
TOTAL NON-OPERATING REVENUES (EXPENSES)	<u>(140,843)</u>
CHANGE IN NET ASSETS	<u>(40,691)</u>
Net assets, beginning of year	<u>195,313</u>
NET ASSETS, END OF YEAR	<u><u>\$ 154,622</u></u>

The accompanying notes to financial statements are an integral part of this statement.

Pathways

Proprietary Funds Statement of Cash Flows

For the Fiscal Year Ended September 30, 2005

	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from charges for services	\$ 2,914,252
Other operating revenues	13,309
Cash paid for operating expenses	(2,274,573)
NET CASH PROVIDED BY OPERATING ACTIVITIES	652,988
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:	
Decrease in due from other funds	-
Increase in due to other funds	474,638
Decrease in due from local units	736,840
Transfers from local units	-
NET CASH PROVIDED BY NON-CAPITAL FINANCING ACTIVITIES	1,211,478
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:	
Acquisition and construction of capital assets	(3,128,062)
Proceeds on issuance of long-term debt	2,729,314
Interest payments on long-term debt	(163,930)
Principal payments on long-term debt	(515,366)
NET CASH PROVIDED BY CAPITAL FINANCING ACTIVITIES	(1,078,044)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest income	41,939
Net (increase) in investments	(1,052,271)
(Increase) in fair market value of investments	(18,851)
NET CASH PROVIDED BY INVESTING ACTIVITIES	(1,029,183)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(242,761)
Cash and cash equivalents, beginning of year	988,910
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 746,149
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Net operating (loss)	\$ 100,152
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:	
Depreciation expense	439,476
Changes in assets and liabilities:	
(Decrease) in accounts payable	-
Increase in accrued sick and vacation	76,950
Increase in accrued payroll and related	36,410
TOTAL ADJUSTMENTS	552,836
NET CASH PROVIDED FROM OPERATING ACTIVITIES	\$ 652,988

The accompanying notes to financial statements are an integral part of this statement.

PATHWAYS
Notes to Financial Statements
For the year ended September 30, 2005

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Pathways is an autonomous entity, separate from the county governments which it services and accordingly consists of a separate set of self-balancing funds and accounts. Pathways is, for financial reporting purposes, an Authority under the Michigan Mental Health Code (P.A. 290 of 1995). The accounting policies of Pathways conform to generally accepted accounting principles as applicable to governments. The following is a summary of the more significant policies:

BASIS OF PRESENTATION

During the year Pathways adopted Governmental Accounting Standards Board (GASB) Statement No. 34, which substantially revised the financial statement presentation as described below.

Government-Wide Financial Statements:

The Statement of Net Assets and Statement of Activities display information about Pathways as a whole. They include all funds of Pathways. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through State sources, intergovernmental revenues, and other non-exchange revenues. Pathways currently does not engage in any business-type activities defined as activities financed in whole or in part by fees charged to external parties for goods or services. Equity is classified as net assets and displayed in three components – invested in capital assets, net of related debt, restricted, and unrestricted.

Fund Financial Statements:

The accounts of Pathways are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures. Government resources are allocated to and accounted for in individual funds based upon the purposes for which they are to be spent and the means by which spending activities are controlled. The various funds are grouped in the financial statements in this report into two major categories: governmental and proprietary categories. An emphasis is placed on major funds within the governmental category. The General Fund is always considered a major fund and the remaining funds of Pathways are considered major if the total assets, liabilities, revenues or expenditures of that individual governmental fund are at least 10 percent of the corresponding total for all governmental funds in accordance with the criteria.

Pathways' reports the General Fund as its only major governmental fund in accordance with the above criteria. The funds of Pathways are described below:

Governmental Funds

General Fund – The General Fund is the main operating fund and accordingly, it is used to account for all financial resources except those required to be accounted for in another fund.

Debt Service Fund – The Debt Service Fund is used to account for the accumulation of resources for, and the payment of, general long-term debt principal, interest, and related costs.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Special Revenue Fund – The Special Revenue Fund is used to account for proceeds of specific revenue sources that are restricted to expenditures for specific purposes. The Ray of Sunshine Fund is a special revenue fund type.

Proprietary Funds

Internal Service Fund – The Internal Service Fund is used to account for the financing of goods or services provided by one department or agency to other departments or agencies of Pathways or to other governments, on a cost-reimbursement basis. The Employee Benefit Fund, Medicaid Risk Reserve Fund and Equipment Fund are internal service funds.

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe “which” transactions are recorded within the various financial statements. Basis of accounting refers to “when” transactions are recorded regardless of the measurement focus applied.

Measurement Focus

On the government-wide Statement of Net Assets and the Statement of Activities, the governmental activities are presented using the economic resource measurement focus as defined in item (b) below. In the fund financial statements, the “current financial resources” measurement focus or the “economic resources” measurement focus is used as appropriate:

- a. All governmental funds utilize a “current financial resources” measurement focus. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable resources at the end of the period.
- b. The proprietary funds utilize an “economic resources” measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets, financial position and cash flows. All assets and liabilities, whether current or noncurrent, associated with their activities are reported. Proprietary fund equity is classified as net assets.

Basis of Accounting

In the government-wide Statement of Net Assets and Statement of Activities, governmental activities are presented using the accrual basis of accounting. Also, the proprietary fund financial statements are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

In the fund financial statements, governmental funds are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when “measurable and available.” Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or within sixty days after year-end. Expenditures, including capital outlay, are generally recognized when the related fund liability is incurred.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

OTHER SIGNIFICANT ACCOUNTING POLICIES

Cash and Equivalents

Pathways cash and cash equivalents as reported in the Statement of Cash Flows and the Statement of Net Assets are considered to be cash on hand, demand deposits and short-term investments with maturities of three months or less when purchased.

Receivables

All receivables are reported at their gross value and, where appropriate, are reduced by the estimated portion that is expected to be uncollectible.

Interfund Activity

During the course of its operations, Pathways has numerous transactions between funds to finance operations, to provide services and to service debt. To the extent that certain transactions between funds had not been paid or received as of September 30, 2004, balances of interfund accounts receivable or payable have been recorded in the fund financial statements. Interfund activity is eliminated in the government-wide financial statements.

Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market. Inventory in the General Fund consists of expendable supplies.

Capital Assets

The accounting and reporting treatment applied to capital assets associated with a fund are determined by its measurement focus. In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the governmental fund upon acquisition. Capital assets used in proprietary fund operations are accounted for the same as in the government-wide financial statements.

In the government-wide financial statements, all capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Pathways defines capital assets as assets with an initial, individual cost of more than \$5,000.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the Statement of Activities, with accumulated depreciation reflected in the Statement of Net Assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of asset is as follows:

Buildings	25-40 years
Vehicles and equipment	3-15 years

The cost of normal maintenance and repairs is charged to operations as incurred. Renewals and betterments are capitalized and depreciated over the remaining useful lives of the related properties.

Long-Term Debt

The accounting treatment of long-term debt depends on whether the assets are used in governmental fund operations or proprietary fund operations and whether they are reported in the government-wide or fund financial statements. All long-term debt to be repaid from

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

governmental or business-type resources are reported as liabilities in the government-wide statements. Pathways long-term debt consists primarily of notes payable.

Long-term debt for governmental funds is not reported as liabilities in the fund financial statements. The debt proceeds are reported as other financing sources and payments of principal and interest are reported as expenditures. The accounting for proprietary funds is the same in the fund statements as it is in the government-wide statements.

Compensated Absences

Pathways' policies regarding compensated absences permits employees to accumulate earned but unused paid time off, compensation and sick time. The liability for these compensated absences is recorded as long-term debt in the government-wide statements. In the fund financial statements, governmental funds report only the compensated absence liability payable from expendable available financial resources, while proprietary funds report the liability as it is incurred.

Deferred Revenues

In the government-wide statements and proprietary fund financial statements, deferred revenue is recognized when cash, receivables or other assets are received prior to their being earned. In the governmental fund statements, deferred revenue is recognized when revenue is unearned or unavailable. Pathways has reported deferred revenue of \$170,785 in the General Fund for Department of Community Health Medicaid and General Funding that has been received but is unearned.

Revenues

In the government-wide Statement of Activities, revenues are segregated by activity and are classified as either a program revenue or a general revenue. Program revenues include charges to customers or applicants for goods or services, operating grants and contributions and capital grants and contributions. General revenues include all revenues, which do not meet the criteria of program revenues and include revenues such as State funding and interest earnings.

In the governmental fund statements, revenues are reported by source, such as federal sources, state sources and charges for services. Revenues consist of general purpose revenues and restricted revenues. General purpose revenues are available to fund any activity reported in that fund, while restricted revenues are available for a specific purpose or activity and the restrictions are typically required by law or a grantor agency. When both general purpose and restricted revenues are available for use, it is the Pathways policy to use the restricted resources first.

Expenses/Expenditures

In the government-wide Statement of Activities, expenses are segregated by activity and are classified by function. In the governmental fund statements, expenditures are classified by character such as current operations, debt service and capital outlay. In the proprietary fund statements, expenses are classified by operating and non-operating and are sub-classified by function such as personnel services and other services and charges.

NOTE A – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Budgets and Budgetary Accounting

Pathways follows these procedures in establishing the budgetary data reflected in the financial statements:

- a. Prior to October 1, the Executive Director submits to the Board a proposed operating budget for the fiscal year commencing the following October 1. The operating budget includes proposed expenditures and the means of financing them.
- b. Prior to October 1, the budget is legally enacted through passage of a Board resolution.
- c. The Executive Director is authorized to transfer budgeted amounts between departments within any fund; however, any revisions that alter the total expenditures of any fund must be approved by the Board.
- d. Budgets are adopted on a basis consistent with generally accepted accounting principles. Budgeted amounts are as originally adopted, or as amended by the Board. Individual amendments were not material in relation to the original appropriations which were amended.
- e. Encumbrance accounting, under which purchase orders, contracts and other commitments for the expenditure of monies are recorded in order to reserve that portion of the applicable appropriation, is not employed by Pathways because it is at present considered not necessary to assure effective budgetary control or to facilitate effective cash planning and control. Any unexpendable appropriations lapse at the end of the fiscal year.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

NOTE B – DEPOSITS AND INVESTMENTS:

The composition of cash and equivalents and investments as reported in the government-wide Statement of Net Assets is presented below:

	<u>Cash</u>	<u>Investments</u>	<u>Total</u>
Unrestricted	\$(265,526)	\$1,566,166	\$1,300,640
Restricted assets	<u>130,385</u>	<u>627,714</u>	<u>758,099</u>
	<u>\$(135,141)</u>	<u>\$2,193,880</u>	<u>\$2,058,739</u>

Cash and cash equivalents can also be summarized into the following categories:

Deposits:	
Cash in demand accounts	\$(1,511,622)
Cash in savings accounts	<u>1,376,481</u>
	<u>\$(135,141)</u>

NOTE B – DEPOSITS AND INVESTMENTS (Continued):

Custodial Credit Risk – Deposits

Custodial credit risk is the risk that in the event of a bank failure, Pathways' deposits may not be returned to it. State law does not require and Pathways does not have a deposit policy for custodial credit risk. The carrying amounts of Pathways' deposits with financial institutions was \$(135,141) and the bank balance was \$722,720. Of the bank balance, \$68,237 or approximately 9.4% was covered by federal depository insurance according to FDIC regulations.

Investments

As of June 30, 2005, Pathways had the following investments.

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment in Maturities (in Years)</u>		
		<u>Less Than 1</u>	<u>1-5</u>	<u>6-10</u>
Certificates of Deposit	<u>\$2,193,880</u>	<u>\$819,738</u>	<u>\$1,234,061</u>	<u>\$140,081</u>

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of Pathways' investments. Pathways does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

Michigan statutes (Act 196, PA 1997) authorize Pathways to invest in bonds, other direct obligations and repurchase agreements of the United States, certificates of deposits, savings accounts, deposit accounts or receipts of a bank which is a member of the FDIC and authorized to operate in this state, commercial paper rated at the time of purchase within the two highest classifications established by not less than two standard rating services and matures within 270 days from date of purchase, bankers' acceptances of the United States banks, obligations of the State of Michigan and its political subdivisions, external investment pools, and certain mutual funds. Michigan law prohibits security in the form of collateral, surety bond, or another form for the deposit of public money.

Pathways has no investment policy that would further limit its investment choices. Ratings are not required for the type of investments listed above. Pathways investments are in accordance with statutory authority.

NOTE C – ESTIMATED AMOUNT DUE FROM (TO) MICHIGAN DEPARTMENT OF COMMUNITY HEALTH:

The estimated amount due from (to) the Michigan Department of Community Health represents the Board's cost settlement report of services and expenditures for the year ending September 30, 2005 in accordance with the terms of the master contract. The reported costs related to such services are subject to review by the Department.

NOTE D – CAPITAL ASSETS:

All capital assets are recorded at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Capital asset activity for the year ended September 30, 2005 is as follows:

NOTE D – CAPITAL ASSETS (Continued):

	Balance at <u>10/01/04</u>	<u>Additions</u>	<u>Disposals</u>	<u>Adjustments</u>	Balance at <u>9/30/05</u>
Capital assets not being depreciated:					
Land	\$ 363,000	\$194,694	\$10,000	\$ -	\$547,694
Capital assets being depreciated:				-	
Buildings	3,166,761	2,097,513	226,000	-	5,038,274
Building improvements	89,670	5,385	-	-	95,055
Equipment and furnishings	2,348,512	575,200	113,295	-	2,810,417
Vehicles	<u>1,441,356</u>	<u>255,270</u>	<u>203,848</u>	-	<u>1,492,778</u>
Total Capital Assets	<u>7,409,299</u>	<u>3,128,062</u>	<u>553,143</u>	-	<u>9,984,218</u>
Less accumulated depreciation:					
Buildings	1,185,738	187,231	99,440	(2,000)	1,271,529
Building improvements	43,177	5,666	-	-	48,843
Equipment and furnishings	1,530,146	252,880	84,972	(24,233)	1,673,821
Vehicles	<u>1,084,615</u>	<u>155,770</u>	<u>203,848</u>	<u>(61)</u>	<u>1,036,476</u>
Total Accumulated Depreciation	<u>3,843,676</u>	<u>601,547</u>	<u>388,260</u>	<u>(26,294)</u>	<u>4,030,669</u>
Capital Assets, net	<u>\$3,565,623</u>	<u>\$2,526,515</u>	<u>\$164,883</u>	<u>\$26,294</u>	<u>\$5,953,549</u>

Depreciation expense was charged to governmental activities as follows:

Governmental Activities:	
General government	\$162,071
Internal service funds charged to above activities	439,476
Total	<u>\$601,547</u>

NOTE E – UNPAID CLAIMS:

The Board estimates its liability for unpaid health insurance claims on the basis of the date the claim was incurred and historical experience. As of September 30, 2005, the amount of unpaid claims in the accompanying financial statements is \$187,182.

NOTE F – INTERNAL SERVICE FUND ACCRUED LIABILITIES:

Prior to March 10, 1997 regular employees annually earned hours of sick leave. For those employees hired before October 1, 1981 the sick leave was paid out upon termination or retirement at a rate of 50% of the sick leave balance to a maximum of 600 hours (1,200 hours x 50%). For those employees hired after October 1, 1981 the payment was paid out only upon retirement, vesting under both situations occurred after 10 years of service.

The new policy, which became effective March 10, 1997, accrues all employees' sick annual, bonus and personal leave in one leave bank, referred to as Paid Time Off (PTO). In addition to PTO, each full time employee will be given 32 hours of paid, extended/restricted sick leave per year to be used only for major medical events. Extended/Restricted sick leave cannot accrue; therefore, there will be no pay out of this sick leave at retirement or termination. An employee may earn one extra bonus day of PTO per year.

Separation from service entitles the employee to payment of the available balance of PTO leave, up to 40 hours compensation time, plus any unused sick leave according to policies in place prior to March 10, 1997.

NOTE F – INTERNAL SERVICE FUND ACCRUED LIABILITIES (Continued):

The amount of vested leave as of September 30, 2005 is as follows:

Paid time off	\$1,293,371
Sick Leave	131,910
Compensation Time	<u>31,335</u>
TOTAL	<u>\$1,456,616</u>

NOTE G – LINE OF CREDIT:

As of September 30, 2005, Pathways had a secured credit agreement with maximum borrowings of \$1,200,000 to be utilized for general purposes. At September 30, 2005 the outstanding balance was \$0 as reported in the General Fund. The interest rate is 6.53% per annum.

As of September 30, 2005, Pathways had a secured credit agreement with maximum borrowings of \$300,000 to be utilized for equipment purchases by October 20, 2005. At September 30, 2005, the outstanding balance was \$255,027 as reported in the Internal Service Building & Equipment Fund and is currently payable until a loan agreement is secured. The interest rate is 3.65% per annum.

A summary of changes in short-term debt for the year ended September 30, 2005 is as follows:

	Balance 10/1/04	Additions	Deductions	Balance 9/30/05
Line of Credit - General	\$ 14,515	\$ 1,835,648	\$1,850,163	\$ -
Line of Credit – Equipment	<u>76,393</u>	<u>358,523</u>	<u>179,889</u>	<u>255,027</u>
Totals	<u>\$90,908</u>	<u>\$2,194,171</u>	<u>\$2,030,052</u>	<u>\$255,027</u>

NOTE H – DEFERRED COMPENSATION PLANS:

Pathways offers its employees deferred compensation plans created in accordance with Section 457 of the Internal Revenue Code. The plans, available to all employees, permit them to defer a portion of their current salary until future years. The deferred compensation is not available to the employees until termination, retirement, death or unforeseeable emergency.

The amounts deferred under the plan are held in a custodial account for the exclusive benefit of plan participants and their beneficiaries. The plans' participants have the right to designate how the funds will be invested. Therefore, Pathways has no liability for losses under the plans.

Due to changes in the Internal Revenue Code, the plans' assets are considered to be property of the plans' participants and are no longer subject to Pathways general creditors. Therefore, in accordance with GASB Statement No. 32, plan balances and activities are not reflected in these financial statements.

NOTE I – DEFINED CONTRIBUTION PENSION PLAN:

Pathways provides pension benefits to employees through four defined contribution pension plans, as listed below. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Pathways established the plans in the form of the ICMA Retirement Corporation Governmental Money Purchase

NOTE I – DEFINED CONTRIBUTION PENSION PLAN (Continued):

Plan and Trust, as amended by and as authorized by Section 19A of the Municipal Employee's Retirement System of Michigan Plan Document. The ICMA Retirement Corporation is the Plan Administrator and Pathways has agreed to the commingled investment of assets of the Plan within the ICMA Retirement Trust.

	<u>FICA Alternative</u>	<u>VEMA</u>	<u>Retirement Non- Bargaining</u>	<u>Retirement - Delta Technical/ Support Unit</u>	<u>Retirement- Delta Professional Unit</u>
Employees Covered	All regular status full and part-time Employees	All non-union regular status full and part-time Employees	All regular status non-bargaining full and part time employees hired after 1/1/98	All 3/4 time, full time, and job-share status bargaining technical and support staff employees hired after 4/7/99	All 3/4 time, full time, and Job-share status bargaining Professional staff Employees hired after 4/9/99
Number of Plan Members	306	143	118	17	16
Mandatory Employee Contributions	None	None	None	None	None
Mandatory Employer Contributions	5.00% or 6.20%	1.20%	5.00%	5.00%	5.00%
Vesting Requirements	Immediate	Immediate	4 years (25% per year)	4 years (25% per year)	4 years (25% per year)
Actual Employee Contributions	\$28,177	\$-	\$2,298	-	-
Actual Employer Contributions	<u>672,983</u>	<u>48,347</u>	<u>188,336</u>	<u>20,747</u>	<u>33,861</u>
Total Contributions	<u>\$701,160</u>	<u>\$48,247</u>	<u>\$190,634</u>	<u>\$20,747</u>	<u>\$33,861</u>

NOTE J – LONG-TERM DEBT:

Changes in long-term debt principal during the year ended September 30, 2005 are summarized as follows:

	<u>Balance 10/1/04</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance 9/30/05</u>
Installment contracts	\$ 692,301	\$ -	\$448,191	\$244,110
Equipment Fund – Notes payable	<u>1,358,660</u>	<u>2,370,716</u>	<u>335,402</u>	<u>3,393,974</u>
Total Long-Term Debt	<u>\$2,050,961</u>	<u>\$2,370,716</u>	<u>\$783,593</u>	<u>\$3,638,084</u>

NOTE J – LONG-TERM DEBT (Continued):

Long-term debt at September 30, 2005 consists of the following:

	<u>Issue Date</u>	<u>Original Amount</u>	<u>Interest Rate</u>	<u>Monthly Payment</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Installment Contracts:							
Maple Ridge	04/06/1995	\$170,346	70% Bank Base Rate	\$1,507.33	\$44,111	\$7,483	\$51,594
Wood Ridge	05/01/1995	140,765	70% Bank Base Rate	1,218.12	42,291	8,039	50,330
Baraga Street	03/01/1996	48,500	6.40%	420.00	15,908	2,092	18,000
Spring Street	01/01/1996	93,000	5.80%	775.00	33,606	5,053	38,659
Lincoln House and Lake Bluff	06/23/1998	186,410	5.61%	2,034.00	60,263	5,042	65,305
Mortgage Payable	08/29/2002	657,050	3.91%	12,074.00	47,931	395	48,326
Total Installment Contracts					<u>244,110</u>	<u>28,104</u>	<u>272,214</u>
Equipment Fund - Notes Payable:							
Phone System	02/22/2002	643,000	4.90%	9,075.28	341,238	29,808	371,046
Vehicle	10/01/2002	21,340	0.00%	355.66	8,180	-	8,180
Vehicle	10/01/2002	21,009	0.00%	350.16	8,054	-	8,054
Equipment	08/26/2004	464,350	3.45%	10,369.91	344,421	18,079	362,500
Cedar Hills, North Bluff, Gwinn	06/22/2004	448,233	3.95%	2,381.92	436,559	232,995	669,554
DeFant Building	10/05/2004	2,050,000	5.10%	16,318.26	1,956,567	784,901	2,741,468
Equipment	05/27/2005	174,861	3.65%	3,927.05	161,203	11,244	172,447
Great Plains System	06/24/2005	145,855	0.00%	4,051.53	137,752	-	137,752
Total Notes Payable					<u>3,393,974</u>	<u>1,077,027</u>	<u>4,471,001</u>
					<u>\$3,638,084</u>	<u>\$1,105,131</u>	<u>\$4,743,215</u>

As of September 30, 2005, the aggregate maturities of long-term debt are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$524,591	\$157,139	\$681,730
2007	495,472	137,229	632,701
2008	478,641	116,799	595,440
2009	219,160	99,311	318,471
2010	135,378	90,484	225,862
2011-2015	780,046	341,966	1,122,012
2016-2020	800,133	126,058	926,191
2021-2025	113,195	29,720	142,915
2026-2029	91,468	6,425	97,893
TOTALS	<u>\$3,638,084</u>	<u>\$1,105,131</u>	<u>\$4,743,215</u>

NOTE K – DEFICIT NET ASSETS/FUND BALANCE:

The General Fund had a deficit in total fund balance at September 30, 2005 of \$(1,475,027). Pathways' position is that the deficit is a result of under-estimating allowance for doubtful accounts in prior years and reduction in Medicaid funding below costs of providing services. Pathways plans to reduce the deficit through reduction in costs.

The Employee Benefit Fund had a deficit in total net assets at September 30, 2005 of \$(608,464). Pathways' position is that a deficit exists and at present they are unable to remedy the issue. However, Pathways periodically calculates the value of this liability charging or crediting the Fund as appropriate. Pathways plans to reduce the unfunded liability each year to the extent that state and local funding is available.

NOTE L – MEDICAID REIMBURSEMENTS:

Effective October 1, 1998, Pathways entered into a Specialty Community Mental Health Services and Supports Managed Care Contract with the Michigan Department of Community Health (MDCH). Under the Managed Care Contract, the MDCH provides Pathways' state and federal share of Medicaid funds as a capitated payment based on a Per Eligible Per Month methodology for contractually identified and described covered services. Each month of the contract, Pathways receives a prepayment based upon the number of eligibles for that month. This payment methodology replaced the Medicaid reimbursement system in effect through September 30, 1998. In accordance with the contract, Pathways may retain up to 5% of the prepayment as Medicaid savings which are allowed to be treated as local funds and must be expended in the following year. The Medicaid savings must be included in a formal reinvestment strategy which must be directed to the Medicaid population and must be approved by the MDCH.

NOTE M – TRANSFERS IN (OUT):

	Transfer In		Transfer Out
Debt Service Fund	\$477,602	General Fund	\$483,102
Special Revenue Fund	5,500		
TOTALS	\$483,102	TOTALS	\$483,102

NOTE N – DEFINED BENEFIT RETIREMENT PLAN:

The following information is based upon the latest available actuarial valuation (as of December 31, 2004).

Plan Description

Pathways contributes to the Municipal Employees Retirement System of Michigan (System), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agent for all Michigan municipal employees. The System issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to MERS at 1134 Municipal Way, Lansing, MI 48917-9755.

All regularly scheduled full and part-time employees of Pathways are eligible to participate in the System. Benefits vest after ten years of service. Pathways employees who retire at or after the age of 60 with 10 years of credited service are entitled to an annual retirement benefit, payable monthly for life, in an amount equal to the sum of 2.25 percent of a member's final average compensation times years of service, with a maximum benefit of 80% of final average compensation. The System also provides death and disability benefits. These benefit provisions and all other requirements are

NOTE N – DEFINED BENEFIT RETIREMENT PLAN (Continued):

established by State statute and Pathways' Board.

Funding Policy

Employees of Pathways at present are required to contribute two percent of their annual salary to the System. Pathways is currently contributing the remaining amounts necessary to fund the System, using the actuarial basis specified by statute.

Annual Pension Cost

For the year ended September 30, 2005, Pathways' annual pension cost of \$1,194,816 for the plan was equal to Pathways' required and actual contribution. The annual required contribution was determined as part of an actuarial valuation at December 31, 2002, using the entry age normal cost method. Significant actuarial assumptions used in the valuation include (a) a rate of return on the investment of present and future assets of 8%, (b) projected salary increases of 4.5% a year compounded annually, attributable to inflation, and (c) additional projected salary increases of 0.0% to 4.16% per year, depending on age, attributable to seniority/merit. The actuarial value of assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a five year period. The unfunded actuarial accrued liability is being amortized as a level percent of projected payroll on an open basis over a period of 30 years.

Trend Information

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due.

Three-Year Trend Information
Analysis of Funding Progress

Actuarial Valuation Date	Actuarial Accrued Liability (AAL) – Entry Age (a)	Actuarial Value Of Assets (b)	Unfunded AAL (UAAL) (a) – (b)	Funded Ratio (b/a)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((a-b)/c)
12/31/02	\$36,587,574	\$24,933,962	\$11,653,612	68%	\$7,124,649	164%
12/31/03	38,995,925	26,404,421	12,591,504	68	6,753,347	186
12/31/04	41,194,698	27,322,805	13,871,893	66	6,352,834	218

Schedule of Employer Contributions

Fiscal Year Ending September 30	Valuation Date December 31	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2003	2000	\$1,152,979	100%	-
2004	2001	1,100,604	100	-
2005	2002	1,194,816	100	-

NOTE O – RISK MANAGEMENT:

Pathways is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. Pathways was unable to obtain general liability, auto, and property insurance at a cost it considered to be economically justifiable. Pathways joined together with other units to participate in a public entity risk pool currently operating as a common risk management and insurance program. Pathways pay an annual contribution to the pool for its general

NOTE O – RISK MANAGEMENT (Continued):

insurance coverage. The agreement provides that the pool will be self-sustaining through member contributions and will reinsure through commercial companies for claims in excess of \$75,000 for each insured event.

Pathways continues to carry commercial insurance for Physician Malpractice and all other risks of loss. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE P – OWNERSHIP:

Pathways membership is currently divided in proportion to each county's population, based on the 2000 U.S. Census, and is approximately 8.33%, 50.00%, 33.34%, and 8.33% for Alger, Marquette, Delta and Luce Counties respectively. The 2005 financial statements include 100% of the recorded assets of Pathways.

NOTE Q – OTHER POST EMPLOYMENT BENEFITS:

Pathways offers group medical insurance under various collective bargaining agreements covering substantially all employees and former employees of Pathways. The amount paid for former Pathways employees for the fiscal year ended September 30, 2005 was \$23,779 with 53 participants receiving benefits. This benefit is accounted for on the "pay-as-you-go" method, whereby Pathways is reporting the amounts paid as expenditures in the year the amount is paid for the benefit provided. For employees hired after January 1, 1998, Pathways no longer provides group medical insurance after separation from employment with Pathways.

NOTE R – BUDGETARY NONCOMPLIANCE:

Excesses of expenditures over appropriations in individual governmental funds are as follows:

GENERAL FUND:	
Contract services	\$1,991,575
Building rental	13,881
Equipment rental	12,601
Utilities	96,556
Repairs/maintenance	42,573
Staff development	723
Travel	15,480

NOTE S – FUND BALANCE/NET ASSET RESTATEMENT:

The following fund balance/net asset restatements were made as a result of discovering accounting errors and prior period adjustments to Medicaid amounts resulting from Department of Community Health's review of prior period information.

	Governmental Activities	General Fund	Special Revenue Fund
Net assets/fund balance, beginning of year	\$2,060,158	\$388,231	\$77,908
Prior period adjustment for contribution of Trust not previously recorded	14,408		14,408
Prior period adjustment for Medicaid Settlements	(30,018)	(30,018)	-
NET ASSETS/FUND BALANCE, BEGINNING OF YEAR, AS RESTATED	<u>\$2,044,548</u>	<u>\$358,213</u>	<u>\$103,818</u>

REQUIRED SUPPLEMENTARY INFORMATION

Pathways

General Fund Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual For the Fiscal Year Ended September 30, 2005

	Budgeted Amounts		Actual GAAP Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
REVENUES:				
State sources:				
Medicaid - Mental health	\$ 65,820,479	\$ 65,820,479	\$ 64,938,508	\$ (881,971)
Medicaid - Substance abuse	700,000	700,000	728,082	28,082
Medicaid - Child waiver	250,000	250,000	466,983	216,983
General funding	3,827,220	3,827,220	3,767,292	(59,928)
Contracts and grants:				
Mental health	276,904	276,904	291,916	15,012
Substance abuse	2,379,786	2,379,786	2,320,189	(59,597)
Charges for services:				
Client fees except Medicaid	2,245,000	2,245,000	2,085,865	(159,135)
Client revenues - work centers	305,000	305,000	322,403	17,403
Local sources:				
County appropriations	600,972	600,972	603,651	2,679
County liquor tax	425,000	425,000	355,373	(69,627)
Contributions	2,500	2,500	5,327	2,827
Interest income	25,800	25,800	12,869	(12,931)
Other revenues	1,059,995	1,059,995	1,308,480	248,485
Less deductions from revenues:				
Donated services discount	(2,160,065)	(2,160,065)	(1,870,528)	289,537
Local match - QAAP Assessment	(677,900)	(677,900)	(677,900)	-
Local match - Medicaid draw down	(1,303,991)	(1,303,991)	(1,303,991)	-
Public Act 423 of 1980	-	-	(4,402)	(4,402)
TOTAL REVENUES	73,776,700	73,776,700	73,350,117	(426,583)
EXPENDITURES:				
Current operations:				
Personnel services	18,525,440	18,587,932	18,450,769	137,163
Contract services	50,597,289	50,279,065	52,270,640	(1,991,575)
Building rental	1,071,691	566,713	580,594	(13,881)
Supplies	701,913	669,847	645,128	24,719
Equipment rental	15,495	660,978	673,579	(12,601)
Utilities	340,136	325,005	421,561	(96,556)
Insurance	524,083	415,907	402,092	13,815
Repairs/maintenance	377,585	403,419	445,992	(42,573)
Staff development	161,795	126,385	127,108	(723)
Travel	388,904	385,444	400,924	(15,480)
Miscellaneous	385,712	743,837	215,605	528,232
Capital outlay	102,850	66,263	66,263	-
TOTAL EXPENDITURES	73,192,893	73,230,795	74,700,255	(1,469,460)
EXCESS OF REVENUES OVER (UNDER) EXPENDITURES	583,807	545,905	(1,350,138)	(1,896,043)

Pathways

General Fund Schedule of Revenues, Expenditures and Changes in Fund Balance - Budget and Actual For the Fiscal Year Ended September 30, 2005

	Budgeted Amounts		Actual GAAP Basis	Variance with Final Budget Positive (Negative)
	Original	Final		
OTHER FINANCING SOURCES (USES):				
Transfers (out)	\$ (660,444)	\$ (660,444)	\$ (483,102)	\$ 177,342
TOTAL OTHER FINANCING SOURCES (USES)	<u>(660,444)</u>	<u>(660,444)</u>	<u>(483,102)</u>	<u>177,342</u>
NET CHANGE IN FUND BALANCE	<u>(76,637)</u>	<u>(114,539)</u>	<u>(1,833,240)</u>	<u>(1,718,701)</u>
Fund balance, beginning of year	388,231	388,231	388,231	-
Prior period adjustment for Medicaid settlements	<u>-</u>	<u>-</u>	<u>(30,018)</u>	<u>(30,018)</u>
Fund balance, beginning of year, as restated	<u>388,231</u>	<u>388,231</u>	<u>358,213</u>	<u>(30,018)</u>
FUND BALANCE, END OF YEAR	<u>\$ 311,594</u>	<u>\$ 273,692</u>	<u>\$ (1,475,027)</u>	<u>\$ (1,748,719)</u>

OTHER SUPPLEMENTARY INFORMATION

Pathways

Nonmajor Governmental Funds Combining Balance Sheet

September 30, 2005

	Special Revenue Fund Ray of Sunshine Fund	Debt Service Fund	Total Nonmajor Governmental Funds
ASSETS			
Cash and cash equivalents	\$ 4,921	\$ -	\$ 4,921
Investments	84,495	-	84,495
Accounts receivable - other	-	10,060	10,060
Due from other funds	-	-	-
Other assets	14,402	-	14,402
TOTAL ASSETS	<u>\$ 103,818</u>	<u>\$ 10,060</u>	<u>\$ 113,878</u>
LIABILITIES AND FUND BALANCE			
FUND BALANCE:			
Reserved for:			
Debt service	-	10,060	10,060
Unreserved	103,818	-	103,818
TOTAL FUND BALANCE	<u>103,818</u>	<u>10,060</u>	<u>113,878</u>
TOTAL LIABILITIES AND FUND BALANCE	<u>\$ 103,818</u>	<u>\$ 10,060</u>	<u>\$ 113,878</u>

Pathways

Nonmajor Governmental Funds
Combining Statement of Revenues, Expenditures and Changes in Fund Balance

For the Fiscal Year Ended September 30, 2005

	Special Revenue Fund Ray of Sunshine Fund	Debt Service Fund	Total Governmental Funds
REVENUES:			
Private contributions	\$ 10,596	-	\$ 10,596
Investment income	1,256	-	1,256
TOTAL REVENUES	11,852	-	11,852
EXPENDITURES:			
Current operations	5,850	-	5,850
Debt service:			
Principal	-	448,191	448,191
Interest and fiscal charges	-	29,411	29,411
TOTAL EXPENDITURES	5,850	477,602	483,452
EXCESS REVENUES OVER (UNDER) EXPENDITURES	6,002	(477,602)	(471,600)
OTHER FINANCING SOURCES (USES):			
Transfers in	5,500	477,602	483,102
Transfers (out)	-	-	-
TOTAL OTHER FINANCING SOURCES (USES)	5,500	477,602	483,102
NET CHANGE IN FUND BALANCE	11,502	-	11,502
Fund balance, beginning of year	77,908	10,060	87,968
Prior period adjustment for contributions	14,408	-	14,408
Fund balance, beginning of year, as restated	92,316	10,060	102,376
FUND BALANCE, END OF YEAR	\$ 103,818	\$ 10,060	\$ 113,878

Pathways

Internal Service Funds Combining Statement of Net Assets

September 30, 2005

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 5,629	\$ 740,520	\$ -	\$ 746,149
Investments	1,029,705	22,566	-	1,052,271
Due from local units	-	-	-	-
Due from other funds	-	-	-	-
Total current assets	<u>1,035,334</u>	<u>763,086</u>	<u>-</u>	<u>1,798,420</u>
Capital assets:				
Land and improvements	-	-	271,611	271,611
Buildings	-	-	2,531,904	2,531,904
Vehicles	-	-	756,455	756,455
Office equipment	-	-	208,359	208,359
Information technology equipment	-	-	1,401,467	1,401,467
Accumulated depreciation	-	-	(996,534)	(996,534)
Total noncurrent assets	<u>-</u>	<u>-</u>	<u>4,173,262</u>	<u>4,173,262</u>
TOTAL ASSETS	<u>1,035,334</u>	<u>763,086</u>	<u>4,173,262</u>	<u>5,971,682</u>
LIABILITIES				
Current liabilities:				
Accounts payable	-	-	-	-
Due to other funds	-	-	524,261	524,261
Accrued payroll and related	187,182	-	-	187,182
Current maturities of long-term debt	-	-	672,574	672,574
Total current liabilities	<u>187,182</u>	<u>-</u>	<u>1,196,835</u>	<u>1,384,017</u>
Long-term liabilities:				
Compensated absences	1,456,616	-	-	1,456,616
Notes payable	-	-	2,976,427	2,976,427
Total long-term liabilities	<u>1,456,616</u>	<u>-</u>	<u>2,976,427</u>	<u>4,433,043</u>
TOTAL LIABILITIES	<u>1,643,798</u>	<u>-</u>	<u>4,173,262</u>	<u>5,817,060</u>
NET ASSETS				
Invested in capital assets, net of related debt	-	-	-	-
Restricted	-	763,086	-	763,086
Unrestricted	(608,464)	-	-	(608,464)
TOTAL NET ASSETS	<u>\$ (608,464)</u>	<u>\$ 763,086</u>	<u>\$ -</u>	<u>\$ 154,622</u>

Pathways

Internal Service Funds Combining Statement of Revenues, Expenses and Changes in Net Assets

For the Fiscal Year Ended September 30, 2005

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
OPERATING REVENUES:				
Charges for services	\$ 2,319,754	\$ -	\$ 603,566	\$ 2,923,320
Other	4,242	-	-	4,242
TOTAL OPERATING REVENUES	2,323,996	-	603,566	2,927,562
OPERATING EXPENSES:				
Personnel services	2,387,774	-	-	2,387,774
Other services and charges	-	-	160	160
Depreciation	-	-	439,476	439,476
TOTAL OPERATING EXPENSES	2,387,774	-	439,636	2,827,410
OPERATING INCOME (LOSS)	(63,778)	-	163,930	100,152
NON-OPERATING REVENUES (EXPENSES):				
Investment income	20,037	3,050	-	23,087
Interest expense	-	-	(163,930)	(163,930)
Transfers from local units	-	-	-	-
TOTAL NON-OPERATING REVENUES (EXPENSES)	20,037	3,050	(163,930)	(140,843)
CHANGE IN NET ASSETS	(43,741)	3,050	-	(40,691)
Net assets, beginning of year	(564,723)	760,036	-	195,313
NET ASSETS, END OF YEAR	\$ (608,464)	\$ 763,086	\$ -	\$ 154,622

Pathways

Internal Service Funds Combining Statement of Cash Flows

For the Fiscal Year Ended September 30, 2005

	Employee Benefit Fund	Medicaid Risk Reserve Fund	Equipment Fund	Total
CASH FLOWS FROM OPERATING ACTIVITIES:				
Cash received from charges for services	\$ 2,310,686	\$ -	\$ 603,566	\$ 2,914,252
Other operating revenues	13,309	-	-	13,309
Cash paid for operating expenses	(2,274,413)	-	(160)	(2,274,573)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	49,582	-	603,406	652,988
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:				
(Increase) decrease in due from other funds	-	-	-	-
Increase (decrease) in due to other funds	-	-	474,638	474,638
(Increase) decrease in due from local units	-	736,840	-	736,840
Transfers from local units	-	-	-	-
NET CASH PROVIDED (USED) BY NON-CAPITAL FINANCING ACTIVITIES	-	736,840	474,638	1,211,478
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:				
Acquisition and construction of capital assets	-	-	(3,128,062)	(3,128,062)
Proceeds on issuance of long-term debt	-	-	2,729,314	2,729,314
Interest payments on long-term debt	-	-	(163,930)	(163,930)
Principal payments on long-term debt	-	-	(515,366)	(515,366)
NET CASH (USED) BY CAPITAL FINANCING ACTIVITIES	-	-	(1,078,044)	(1,078,044)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Interest income	38,455	3,484	-	41,939
Net (increase) in investments	(1,029,705)	(22,566)	-	(1,052,271)
(Increase) in fair market value of investments	(18,417)	(434)	-	(18,851)
NET CASH PROVIDED BY INVESTING ACTIVITIES	(1,009,667)	(19,516)	-	(1,029,183)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(960,085)	717,324	-	(242,761)
Cash and cash equivalents, beginning of year	965,714	23,196	-	988,910
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 5,629	\$ 740,520	\$ -	\$ 746,149
RECONCILIATION OF OPERATING (GAIN) LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:				
Net operating income (loss)	\$ (63,778)	\$ -	\$ 163,930	\$ 100,152
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:				
Depreciation expense	-	-	439,476	439,476
Changes in assets and liabilities:				
(Decrease) in accounts payable	-	-	-	-
Increase in accrued sick and vacation	76,950	-	-	76,950
Increase in accrued payroll and related	36,410	-	-	36,410
TOTAL ADJUSTMENTS	113,360	-	439,476	552,836
NET CASH PROVIDED FROM OPERATING ACTIVITIES	\$ 49,582	\$ -	\$ 603,406	\$ 652,988

SUPPLEMENTAL REPORTS



ANDERSON, TACKMAN & COMPANY, P.L.C.

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REPORT ON COMPLIANCE AND OTHER MATTERS AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Members of the Board
Pathways
Marquette, Michigan

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2005, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated April 28, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pathways' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*. These instances are described in a separate letter to management of Pathways dated April 28, 2006.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pathway's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting, that, in our judgment could adversely affect Pathway's ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described to management in a separate letter dated April 28, 2006.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, of the reportable conditions described in the separate letter to management of Pathways, we consider this item under the "Allowance for Doubtful Accounts" section to be a material weakness.

Members of the Board
Pathways
Marquette, Michigan

This report is intended solely for the information and use of management, others within the organization, the Board and other federal and state audit agencies and is not intended to be and should not be used by anyone other than these specified parties.

Anderson, Jackman + Company, PLLC
Certified Public Accountants

April 28, 2006



Anderson, Tackman & Company, PLC

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Robert J. Downs, CPA, CVA

Daniel E. Bianchi, CPA

April 28, 2006

To the Board of Directors and
Management of Pathways
200 W. Spring Street
Marquette, Michigan 49855

In planning and performing our audit of the financial statements of Pathways for the year ended September 30, 2005, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control or compliance. However, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to deficiencies in the design or operation of the internal control structure that, in our judgment, could affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

Reportable Conditions

Internal Control System

In any system of internal accounting control one of the main ingredients is a strong reconciliation function. The general ledger contains the accounts and records which are the basis for the preparation of interim financial statements and for them to be free of a material error or irregularity, the necessity for timely reconciliations cannot be overemphasized. We have suggested and good internal control dictates the general ledger accounts be reconciled on a monthly basis and any adjustments to be made be processed timely. The accounts which are most significant in the accounting system that need to be reconciled on a timely basis are:

- Accounts Receivable
- Third Party Revenues

It was also noted during our audit that the general ledger and subsidiary computer systems were not integrating appropriately in the above areas resulting in manual journal entries to be made in the general ledger. Information should be consistent between the general ledger and subsidiary billing systems to provide reliable financial data and we recommend management address this computer integration problem.

We also recommend comprehensive financial statements be prepared on at least a semi-annual basis. The need for current financial information throughout a fiscal year cannot be overemphasized.

To the Board of Directors and
Management of Pathways

Allowance for Doubtful Accounts

The allowance for doubtful accounts was adjusted at year end by \$800,000 which was detected by management and the accounts receivable personnel. The preliminary evaluation indicated the percentages used to calculate the allowance amount were in need of adjustment. However, further review determined this not to be the root cause. The problem revolved around a major recoding of the third-party payers classifications, a collectibility evaluation conducted during the year in the accounts receivable system, and the recording of inpatient capitated services in the self-pay payor balance in the accounts receivable detail. These capitated services were to have been written-off to the general fund funding service and accordingly the donated service discount was understated.

The breakdown impaired the reliability of the financial reporting and effectiveness of operations aspects in the internal control system. We found the system had previously failed to provide complete and accurate output that was consistent with the objectives and current needs.

Our recommendation is that management designate an individual to review the transactions, accounting entries, and system output and report to the Finance Committee on a regular basis to insure the elements of internal control are being adhered to prevent such an occurrence in the future.

Instances of Non-Compliance

Uniform Budgeting and Accounting Act (P.A. 621)

The State of Michigan has enacted Public Act 621, the Uniform Budgeting and Accounting Act, to provide for a system of uniform procedures for the preparation and execution of budgets in local units of government. The purpose of P.A. 621 is to require that all local units of government adopt balanced budgets, to establish responsibilities and define the procedure for the preparation, adoption and maintenance of the budget, and to require certain information for the budget process, including data for capital construction projects. The major provisions of P.A. 621 are as follows:

1. Local Units of government must adopt a budget.
2. The budget, including accrued deficits and available unappropriated surpluses, must be balanced.
3. The budget must be amended when necessary.
4. Debt shall not be entered into unless the debt is permitted by law.
5. Expenditures shall not be incurred in excess of the amount appropriated.
6. Expenditures shall not be made unless authorized in the budget.
7. Violations of the act, disclosed in an audit of the financial records, in the absence of reasonable procedures shall be filed with the State Treasurer and reported to the Attorney General.

Pathways was found to be in violation of the legal and contractual provisions of Public Act 621 in certain individual funds as enumerated upon in Footnote R. Pathways was also found to be in violation of the provisions of Public Act 621 by only adopting the fiscal budget at the Finance Committee level subsequent to the start of the fiscal year. We recommend Pathways adopt the fiscal budget at the full Board level prior to the start of each fiscal year.

To the Board of Directors and
Management of Pathways

Fund Balance/Net Assets Deficit

At September 30, 2005 the following funds had an unrestricted equity deficit:

Fund	Deficit Equity Balance
General Fund	\$1,475,027
Employee Benefit Fund	\$608,464

Public Act 275 of 1980 requires that all deficits in any fund balances of local units be disclosed and enumerated upon in Footnotes of the financial statements (Footnote K). Also, in accordance with the Act, a corrective action plan for the deficit is required to be filed with the State Treasurer within 90 days of the end of the fiscal year. As of this time, Pathways has not filed such a plan. We recommend that Pathways file the necessary deficit elimination plan and monitor these funds closer in future years to ensure there are sufficient revenues to cover the expenditures each year.

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These comments and recommendations were a result of our year-end audit fieldwork and are submitted as constructive suggestions to assist you in strengthening internal controls. We appreciate the cooperation and courtesy extended to us by you and your staff during our audit and would be pleased to discuss our recommendations with you further at your convenience.

This report is intended solely for the use of management.

Anderson, Tackman & Company, PLLC
Certified Public Accountants

**PATHWAYS
FEDERAL FINANCIAL ASSISTANCE
For the Year Ended September 30, 2005**

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ANDERSON, TACKMAN & COMPANY, P.L.C.

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REPORT ON COMPLIANCE AND OTHER MATTERS AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

Members of the Board
Pathways
Marquette, Michigan 49855

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2005, which collectively comprise Pathways' basic financial statements and have issued our report thereon dated April 28, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether Pathways' financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance and other matters that are required to be reported under *Government Auditing Standards*. These instances are described in the accompanying schedule of findings and questioned costs under Section II, item number 05-3.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Pathways' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting, that, in our judgment could adversely affect Pathways' ability to record, process, summarize and report financial data consistent with the assertions of management in the financial statements. Reportable conditions are described in the accompanying schedule of findings and questioned costs under Section II, items number 05-1 and 05-2.

Members of the Board
Pathways
Marquette, Michigan 49855

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of management, others within the organization, the Board, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Anderson, Tackman & Company, PLC
Certified Public Accountants

April 28, 2006



ANDERSON, TACKMAN & COMPANY, P.L.C.

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REPORT ON COMPLIANCE WITH REQUIREMENTS APPLICABLE TO EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

Members of the Board
Pathways
Marquette, Michigan 49855

Compliance

We have audited the compliance of Pathways with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended September 30, 2005. Pathways' major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of Pathways' management. Our responsibility is to express an opinion on Pathways' compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Pathways' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on Pathways' compliance with those requirements.

In our opinion, Pathways complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended September 30, 2005.

Internal Control Over Compliance

The management of Pathways is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered Pathways' internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

Members of the Board
Pathways
Marquette, Michigan 49855

Our consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grant agreements that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over compliance and its operation what we consider to be material weaknesses.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Pathways, as of and for the year ended September 30, 2005, and have issued our report thereon dated April 28, 2006. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the Pathways' basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

This report is intended solely for the information and use of management, others within the organization, the Board, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Anderson, Tackman & Company, PLC
Certified Public Accountants

April 28, 2006

Pathways
Schedule of Expenditures of Federal Awards
For the year ended September 30, 2005

Federal Grantor/Pass Through Grantor Program Title	Federal C.F.D.A. Number	Project Number	Project Period	Award Amount	Federal Expenditures
U.S. Department of Health & Human Services:					
Passed through the Michigan Department of Community Health:					
Juvenile Justice Diversion	93 958	20051069	10/1/04-9/30/05	\$ 62,475	\$ 30,554
SED Respite Services	93 958	20051069	10/1/04-9/30/05	7,645	3,225
Dial-a-Ride	93 958	20051069	10/1/04-9/30/05	5,000	4,032
Getting into the Getaway	93 958	20051069	10/1/04-9/30/05	3,275	3,271
Brantley Drop-In Center	93 958	20051069	10/1/04-9/30/05	4,000	4,000
					<u>45,082</u>
Block Grant for Prevention and Treatment of Substance Abuse:					
Substance Abuse Coordinating Agency	* 93 959	20051101	10/1/04-9/30/05	220,450	99,203
Prevention	* 93 959	20051101	10/1/04-9/30/05	510,257	382,693
Treatment	* 93 959	20051101	10/1/04-9/30/05	1,103,098	827,324
Women and Family	* 93 959	20051101	10/1/04-9/30/05	119,510	89,633
					<u>1,398,853</u>
Substance Abuse and Mental Health Services-Projects of Regional and National Significance:					
State Incentive Grant (SIG)	93 243	20051101	10/1/04-9/30/05	206,595	206,595
OBRA	93 778	N/A	10/1/04-9/30/05	86,215	86,215
					<u>1,736,745</u>
Total U.S. Department of Health & Human Services					
U.S. Department of Justice - Office of Juvenile Justice Delinquency Program:					
Passed through Eastern U.P. Substance Abuse Services:					
Connections for Upper Peninsula Youth	16 729	2003-JNFX0063(F-1)	10/1/02-9/30/05	75,000	75,000
					<u>75,000</u>
Total U.S. Department of Justice					
U.S. Department of Education:					
Passed through the Department of Career Development - Michigan Rehabilitation Services:					
Community Rehabilitation Program - Nordic Woven Originals	84 126	2005-59341-S8532	10/1/04-9/30/05	25,828	18,366
					<u>18,366</u>
Total U.S. Department of Education					

Pathways
Schedule of Expenditures of Federal Awards
For the year ended September 30, 2005

Federal Grantor/Pass Through Grantor Program Title	Federal C.F.D.A. Number	Project Number	Project Period	Award Amount	Federal Expenditures
U.S. Department of Housing & Urban Development:					
Passed through the Michigan Department of Community Health Shelter Plus Care	14.238	20050715	10/1/04-9/30/05	33,924	\$ 5,223
Total U.S. Department of Housing & Urban Development					<u>5,223</u>
TOTAL FEDERAL FINANCIAL ASSISTANCE					<u><u>\$ 1,835,334</u></u>

* Denotes a major program

PATHWAYS
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
For the Year Ended September 30, 2005

NOTE A - BASIS OF PRESENTATION:

The accompanying schedule of expenditures of federal awards includes the federal grant activity of Pathways and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

NOTE B - OVERSIGHT AGENCY:

The U.S. Department of Health and Human Services is the current year's oversight agency for the single audit as determined by the agency providing the largest share of Pathways' federal financial assistance.

NOTE C - SUBRECIPIENTS:

Of the federal expenditures presented in the schedule, Pathways provided federal awards to subrecipients as follows:

<u>Program Title</u>	<u>Federal CFDA Number</u>	<u>Amount Provided to Subrecipient</u>
Block Grant for Prevention and Treatment of Substance Abuse:		
Prevention	93.959	\$382,693
Treatment	93.959	827,324
Women and Family	93.959	89,633
Substance Abuse and Mental Health Services- Projects of Regional and National Significance:		
State Incentive Grant (SIG)	93.243	206,595

PATHWAYS
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2005

Section I - Summary of Auditors' Results

Financial Statements

- Type of auditors' report issued: Unqualified
- Internal control over financial reporting:
 - Material weaknesses were identified (refer to Section II)..
 - There were reportable conditions reported (refer to Section II).
- Noncompliance items material to the financial statements were identified (refer to Section II).

Federal Awards

- Internal Control over major programs:
 - No material weaknesses were identified.
 - No reportable conditions not considered to be material weaknesses were identified.
- Type of auditors' report issued on compliance for major programs: Unqualified.
- Audit findings that are required to be reported in accordance with Circular A-133, Section .510(a): None.

Major Program

- The program tested as a major program was:
 - Block Grant for Prevention and Treatment of Substance Abuse CFDA# 93.959
- Dollar threshold used to distinguish between Type A and Type B programs: \$300,000.
- Auditee qualified as low-risk auditee? Yes.

Section II - Financial Statement Findings

- The following reportable conditions were noted:

05-1 Condition: The accounting system at Pathways contains general ledger accounts that are not being reconciled on a timely basis.

Criteria: Internal controls should be in place to ensure general ledger accounts are reconciled timely.

Effect: The general ledger contains the accounts and records which are the basis for the preparation of the interim financial statements and for the financial statements to be free of a material error or irregularity the general ledger accounts need to be reconciled timely.

Recommendation: Management should reconcile all general ledger accounts on a monthly basis and any adjustments to be made should be processed timely.

Management Response: Management concurs.

PATHWAYS
SCHEDULE FINDINGS AND QUESTIONED COSTS (Continued)
For the Year Ended September 30, 2005

- 05-2** **Condition:** The allowance for doubtful accounts was adjusted at year-end by \$800,000 which was detected by management and was a result of an evaluation of and changes made to the accounts receivable billing system.

Criteria: Internal controls should be in place to ensure the financial output from the accounts receivable subsidiary and general ledger systems are reliable

Effect: The general ledger contains the accounts and records which are the basis for the preparation of the interim financial statements and for the financial statements to be free of a material error or irregularity the financial output from the subsidiary and general ledger systems needs to be reliable.

Recommendation: Management should review and approve the transactions, accounting entries and system output from the subsidiary ledgers as well as the general ledger to ensure reliable financial data is being processed.

Management Response: Management concurs.

- The following noncompliance item was noted:

- 05-3** **Condition:** Pathways was found to be in violation of the legal and contractual provisions of Public Act 621 whereby excesses of expenditures over appropriations existed in certain individual funds as enumerated in Footnote R of the financial statements and the fiscal budget was not adopted at the full Board level prior to the start of the fiscal year.

Criteria: Internal controls should be in place to ensure expenditures do not exceed appropriations and the fiscal budget is adopted in accordance with the provisions of Public Act 621.

Effect: When expenditures exceed appropriations, Pathways is in violation of Public Act 621 and there is a potential negative impact on the financial position.

Recommendation: Pathways should monitor expenditures throughout the fiscal year to ensure expenditures do not exceed appropriations and Pathways should adopt the budget at the full Board level instead of just the Finance Committee level prior to the start of the fiscal year.

Management Response: Management concurs.

Section III - Federal Award Findings and Questioned Costs

- There were no findings and/or questioned costs identified.

PATHWAYS
SCHEDULE OF PRIOR YEAR FINDINGS AND QUESTIONED COSTS
For the Year Ended September 30, 2005

There were no prior year findings or questioned costs relating to
Pathways' major programs.